

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

In the Matter of the Protest of	)	
	)	DOCKET NO. 19422
[Redacted],	)	
	)	DECISION
Taxpayer.	)	
_____	)	

On February 24, 2006, the staff of the Sales Tax Audit Bureau (Bureau) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination [Redacted] (taxpayer) proposing sales and use tax, penalty, and interest for the period of July 1, 2002, through June 30, 2005, in the total amount of \$6,447.

On April 27, 2006, the taxpayer filed a timely appeal and petition for redetermination.

The taxpayer requested an informal hearing with the Commission. The hearing was held on March 2, 2007.

Idaho Code § 63-3621 imposes a use tax on the storage, use, or other consumption of tangible personal property in Idaho. The use tax rate is the same as the sales tax rate. Any liability for use tax is extinguished if the purchaser pays sales tax to the seller at the time of purchase. In other words, use tax is only imposed on purchases for which the seller did not charge sales tax. The taxpayer raised objections to the imposition of use tax on purchases of five specific items or types of items.

The first item was the purchase of several 400 watt halogen lamps. [Redacted]. [Redacted]. In its protest letter the taxpayer argued that the lights increased productivity. The taxpayer did not raise this argument at the hearing and, in fact, said that the lights were not used to increase production. The taxpayer did argue that the lights were necessary and that their

purchase should be exempt under Idaho Code § 63-3622D, commonly known as the “production exemption.” This statute states:

**63-3622D. PRODUCTION EXEMPTION.** There are exempted from the taxes imposed by this chapter:

(a) The sale at retail, storage, use or other consumption in this state of:

(1) Tangible personal property which will enter into and become an ingredient or component part of tangible personal property manufactured, processed, mined, produced or fabricated for sale.

(2) Tangible personal property primarily and directly used or consumed in or during a manufacturing, processing, mining, farming, or fabricating operation, including, but not limited to, repair parts, lubricants, hydraulic oil, and coolants, which become a component part of such tangible personal property; provided that the use or consumption of such tangible personal property is necessary or essential to the performance of such operation.

(3) Chemicals, catalysts, and other materials which are used for the purpose of producing or inducing a chemical or physical change in the product or for removing impurities from the product or otherwise placing the product in a more marketable condition as part of an operation described in subsection (a)(2) of this section, and chemicals and equipment used in clean-in-place systems in the food processing and food manufacturing industries.

(4) Safety equipment and supplies required to meet a safety standard of a state or federal agency when such safety equipment and supplies are used as part of an operation described in subsection (a)(2) of this section.

(5) Plants to be used as part of a farming operation.

(b) Other than as provided in subsection (c) of this section, the exemptions allowed in subsections (a)(1), (a)(2), (a)(3) and (a)(4) of this section are available only to a business or separately operated segment of a business which is primarily devoted to producing tangible personal property which that business will sell and which is intended for ultimate sale at retail within or without this state. A contractor providing services to a business entitled to an exemption under this section is not exempt as to any property owned, leased, rented or used by it unless, as a result of the terms of the contract, the use of the property is exempt under section 63-3615(b), Idaho Code.

(c) The exemptions allowed in subsections (a)(1), (a)(2), (a)(3) and (a)(4) of this section shall also be available to a business, or separately operated segment of a business, engaged in farming or mining, whether as a subcontractor, contractor, contractee or subcontractee, when such business or segment of a

business is primarily devoted to producing tangible personal property which is intended for ultimate sale at retail within or without this state, without regard to the ownership of the product being produced.

(d) As used in this section, the term "directly used or consumed in or during" a farming operation means the performance of a function reasonably necessary to the operation of the total farming business, including, the planting, growing, harvesting and initial storage of crops and other agricultural products and movement of crops and produce from the place of harvest to the place of initial storage. It includes disinfectants used in the dairy industry to clean cow udders or to clean pipes, vats or other milking equipment.

(e) The exemptions allowed in this section do not include machinery, equipment, materials and supplies used in a manner that is incidental to the manufacturing, processing, mining, farming or fabricating operations such as maintenance and janitorial equipment and supplies.

(f) Without regard to the use of such property, this section does not exempt:

(1) Hand tools with a unit purchase price not in excess of one hundred dollars (\$100). A hand tool is an instrument used or worked by hand.

(2) Tangible personal property used in any activities other than the actual manufacturing, processing, mining, farming or fabricating operations such as office equipment and supplies, and equipment and supplies used in selling or distributing activities.

(3) Property used in transportation activities.

(4) Machinery, equipment, tools or other property used to make repairs. This subsection does not include repair parts that become a component part of tangible property exempt from tax under this section or lubricants, hydraulic oil, or coolants used in the operation of tangible personal property exempt under this section.

(5) Machinery, equipment, tools or other property used to manufacture, fabricate, assemble or install tangible personal property which is:

(i) Not held for resale in the regular course of business; and

(ii) Owned by the manufacturer, processor, miner, farmer or fabricator; provided, however, this subsection does not prevent exemption of machinery, equipment, tools or other property exempted from tax under subsection (a)(2) or (a)(3) of this section.

(6) Any improvement to real property or fixture thereto or any tangible personal property which becomes or is intended to become a component of any real property or any improvement or fixture thereto.

(7) Motor vehicles and aircraft.

(8) Tangible personal property used or consumed in processing, producing or fabricating tangible personal property exempted from tax under this chapter in sections 63-3622F and 63-3622I, Idaho Code.

(9) Tangible personal property described in section 63-3622HH, Idaho Code.

(g) Any tangible personal property exempt under this section which ceases to qualify for this exemption, and does not qualify for any other exemption or exclusion of the taxes imposed by this chapter, shall be subject to use tax based upon its value at the time it ceases to qualify for exemption. Any tangible personal property taxed under this chapter which later qualifies for this exemption shall not entitle the owner of it to any claim for refund.

Thus, the production exemption applies to purchases of tangible personal property that are primarily and directly used in manufacturing or processing. The Commission acknowledges that the lamps are necessary for the employees to see; however, the Commission does not believe that they are directly used in production. The Commission also notes that the legislative committee which drafted the legislation that eventually became Idaho Code § 63-3622D submitted a report that "set forth the considerations which guided it in arriving at the conclusions which are expressed" in the Sales Tax Act. House Revenue and Taxation Committee Report in Support of House Bill 222 (May 4, 1965), p. 1. The legislative committee indicated that the report should "function as a guide to the office of the Tax Collector in administration of this act." One of the items specifically listed as taxable was "material that becomes part of a building housing a manufacturing plant." The Commission finds that the lights in this case are a part of the building and do not serve any purpose [Redacted] other than to provide light to the workers. Therefore, purchases of these lights are not exempt.

The second item was the purchase of several terry wash cloths. [Redacted]. The auditor determined that these cloths were hand tools. The use of hand tools with a unit value of less than \$100 is excluded from the production exemption by Idaho Code § 63-3622D(f)(1). The

Commission has determined previously, in an unpublished decision, that paper towels used for the same purpose were not hand tools. The only distinction between the two is that the cloth towels are reusable; the paper towels are not. This distinction does not appear relevant. The Commission finds, therefore, that the use of the cloth towels [Redacted] is exempt, as is the use of paper towels.

The third issue is the imposition of use tax on the purchase of a handheld device used to measure the vibrations [Redacted]. Arguably, the use of this item is excluded by subsection (e) of Idaho Code § 63-3622D since it is used for maintenance.

The taxpayer also stated that it has not used the device. Currently, the taxpayer pays a third party to calibrate [Redacted]. For this reason, the Commission finds that the device is also not necessary [Redacted].

Fourth is the purchase of a truck scale. [Redacted]. The trucks are weighed when they are empty, [Redacted], and then weighed again while they are full. Although this scale is necessary for accounting, inventory, and billing purposes, it is not involved in the production [Redacted]. Subsections 63-3622D(f)(2) and 63-3622D(f)(3) exclude from the exemption property used in selling and distribution activities and property used in transportation. Since the scale is used in both distribution and transportation activities, its use does not qualify for the exemption.

The fifth and final item is a \$19,000 purchase that was coded to the account for the [Redacted]. The taxpayer did not have an invoice for this purchase. The taxpayer did locate a copy of the invoice after the hearing and forwarded a copy to the Commission. This purchase was a progress payment made to a construction contractor and is not subject to use tax.

In summary, the Commission finds that the use of the halogen lamps, the [Redacted] calibration device, and the truck scale are taxable. The use of the wash cloths and the payment to the building contractor are not taxable. The Commission, in its discretion, is also waiving the negligence penalty.

WHEREFORE, the Notice of Deficiency Determination dated February 24, 2006, is MODIFIED, and as MODIFIED, is APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following tax and interest:

<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
\$3,445	\$809	\$4,254

Interest is calculated through April 30, 2007, and will continue to accrue at the rate set forth in Idaho Code § 63-3045(6) until paid.

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the taxpayer's right to appeal this decision is included with this decision.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2007.

IDAHO STATE TAX COMMISSION

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COMMISSIONER

## CERTIFICATE OF SERVICE

I hereby certify that on this \_\_\_\_\_ day of \_\_\_\_\_, 2007, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]

Receipt No.

[Redacted]

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